

GAO

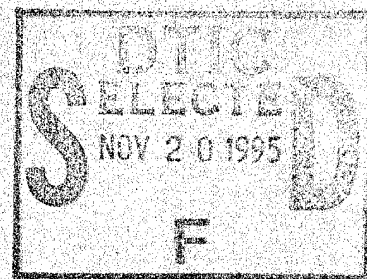
United States General Accounting Office

Report to Congressional Requesters

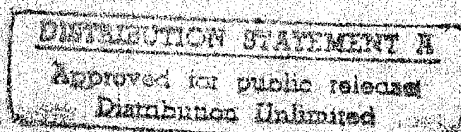
September 1995

FEDERALLY FUNDED R&D CENTERS

Use of Contract Fee by The Aerospace Corporation



19951115 105



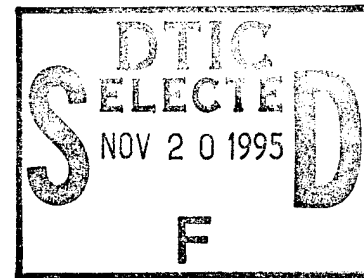
DTIC QUALITY INSPECTED 3

National Security and
International Affairs Division

B-259377

September 28, 1995

The Honorable Bill Zeliff
Chairman
The Honorable Karen L. Thurman
Ranking Minority Member
Subcommittee on National Security,
International Affairs, and Criminal Justice
Committee on Government Reform and Oversight
House of Representatives



As requested by the former Chairman and Ranking Minority Member, we reviewed how The Aerospace Corporation used a \$15.5 million contract fee provided by the Air Force in fiscal year 1993 to operate a federally funded research and development center (FFRDC). We also reviewed the regulatory requirements governing the determination and use of this fee. This is our second report on Aerospace. Our first report addressed executive compensation, as requested.¹

Results in Brief

Aerospace spent \$11.5 million, or 74 percent, of its \$15.5 million fee for research. It spent the remaining \$4 million for capital equipment purchases, real and leasehold property improvements, and unreimbursed expenses.

Accession For	
NTIS CRA&I	<input checked="" type="checkbox"/>
DTIC TAB	<input type="checkbox"/>
Unannounced	<input type="checkbox"/>
Justification	
By	
Distribution /	
Availability Codes	
Dist	Avail and/or Special
A-1	

Even though the Air Force and Aerospace discuss Aerospace's specific fee needs and intended use as a basis for fee award, the contract contains the total fee amount. Once the Air Force awards the fee, Aerospace exercises some discretion over how to spend it and other sources of corporate funds, such as interest income and fee from other contracts. The manner in which Aerospace spends its corporate funds in a given year can affect how much Air Force fee is needed in the following year.

In May 1995, the Department of Defense (DOD) issued a report to the Congress on fee management at defense FFRDCs. The report focused on ways to limit the use of fee. It recommended, among other things, that (1) defense FFRDC fee amounts be based on the contracting officer's determination of fee need and not on the application of weighted guidelines,² (2) all allowable and allocable costs be moved from fee to the

¹Federally Funded R&D Centers: Executive Compensation at The Aerospace Corporation (GAO/NSIAD-95-75, Feb. 7, 1995).

²These guidelines focus on performance risk, contract type, and facilities capital employed.

cost reimbursement portion of the contract, and (3) guidance be developed regarding what costs are to be considered ordinary and necessary to the operation of an FFRDC. DOD has indicated that it is working to improve the fee management process based on these recommendations, as well as the most recent GAO and DOD Inspector General work on this issue.

Background

FFRDCs are private sector organizations funded primarily by federal agencies to meet a special long-term research and development need that cannot be met as effectively by existing in-house or contractor resources. One federal agency serves as the primary sponsor of the FFRDC and signs an agreement specifying the purpose, terms, and other provisions for the FFRDC's existence. Agreement terms cannot exceed 5 years but can be extended after a review by the sponsor of the continued use and need for the FFRDC. Federal regulations state that an FFRDC is required to conduct its business in a manner befitting its special relationship with the government, operate in the public interest with objectivity and independence, be free from organizational conflicts of interest, and have full disclosure of its affairs to the sponsoring agency.

The Aerospace Corporation is a private, nonprofit mutual benefit corporation created in 1960. Aerospace's primary purpose is to provide scientific and engineering support for the U.S. military space program. Aerospace operates an FFRDC in support of U.S. national security space programs pursuant to the Federal Acquisition Regulation (FAR), and its primary sponsor is the Air Force. Aerospace is governed by a 16-member Board of Trustees in accordance with its articles of incorporation and bylaws.

The Air Force Space and Missile Systems Center (SMC), a part of the Air Force Materiel Command, has day-to-day management responsibility over the FFRDC. Through fiscal year 1994, SMC negotiated annual cost-plus-fixed-fee contracts with Aerospace. In fiscal year 1995, it began operating under a cost-plus-award-fee contract where the amount of fee is based on Aerospace's performance. Table 1 shows the contract costs and fees awarded to Aerospace between fiscal years 1989 and 1994.

Table 1: Air Force Contract Costs and Fees With Aerospace Between 1989 and 1994

Dollars in millions		
Fiscal year	Contract costs	Fee
1989	\$371.4	\$19.0
1990	389.8	20.5
1991	375.6	19.9
1992	373.5	16.8
1993	401.7	15.5
1994	355.4	15.6

Although SMC is the primary customer, Aerospace also performs work for other U.S. government agencies, international organizations, and foreign governments. In fiscal year 1993, for example, Aerospace's reported revenues totaled \$422.2 million, of which 97.4 percent came from the Air Force and other DoD agencies; 2.2 percent from other federal agencies, such as the National Aeronautics and Space Administration; and 0.4 percent from nonfederal government sources, such as universities and foreign governments.

Regulatory Requirements on FFRDC Fee

The Office of Federal Procurement Policy Letter 84-1, dated April 1984, established governmentwide policies for the establishment, use, review, and termination of the sponsorship of FFRDCs. It provides that the conditions affecting the negotiation of fee should be identified in the contract, sponsoring agreement with the FFRDC, or the sponsoring agency's policies and procedures, as appropriate.

The FAR also requires that the sponsoring agreement or the sponsoring agency's policies and procedures identify the considerations that will affect the negotiation of fee when fee is determined to be appropriate. The Defense Acquisition Regulation Supplement (DFARS) provides more specific guidance for determining whether a fee is appropriate and how the fee is to be determined. Since FFRDCs may incur expenses that are unreimbursable under federal regulations, the DFARS allows for a fee to cover unreimbursed expenses if they are deemed ordinary and necessary to the FFRDC. An SMC contracting office instruction provides the fee determination procedures to be used on the Aerospace contract. It states that the fee is to be based on a need that must be justified and that the fee must be used for the purposes awarded.

Aerospace's Use of Fee

In fiscal year 1993, Aerospace reported that it used about \$11.5 million of the \$15.5 million Air Force contract fee to sponsor research. It used the remainder of the fee, along with other corporate resources, for capital equipment purchases, real and leasehold property improvements, and other unreimbursed expenditures.

According to Aerospace officials, the fee from Air Force contracts is combined with funds from other sources in Aerospace's accounting records. Therefore, it is not possible to link each specific use of Aerospace's funds to the specific funding source. However, Aerospace and SMC have a general understanding that sponsored research is to be paid from the Air Force contract fee. Also, the accounting standards and principles governing Aerospace do not require it to match funding use with funding source. Table 2 shows Aerospace's actual sources and applications of funds in fiscal year 1993.

Table 2: Sources and Applications of Funds at Aerospace for Fiscal Year 1993

Sources of funds	Amount
Air Force contract fee	\$15.5
Equipment depreciation	13.5
Leasehold amortization	1.0
Interest income	0.9
Working capital change	0.4
Other contract fees	0.2
Total	\$31.5
Applications of funds	
Research	\$11.5
Capital equipment	14.3
Real and leasehold property improvements	3.8
Unreimbursed expenses	1.9
Total	\$31.5

Research

Aerospace used the Air Force fee primarily to sponsor research with broader and longer term goals than the more immediate, direct goals of individual Air Force program offices. In fiscal year 1993, Aerospace spent about \$11.5 million, or 74 percent, of the Air Force fee for sponsored research.

According to Aerospace officials, these funds were used for research in such areas as electronic device technology, surveillance, and information

sciences. They added that sponsored research has resulted in cost savings for the Air Force space program. For example, Aerospace attributed to such research a 50-percent increase in the life expectancy of satellite sensors in the Defense Meteorological Satellite Program. It credited such research with developing remedial procedures to extend the life of satellite batteries, which have historically contributed to limiting the life of the satellite. Aerospace also cited many other research benefits, such as combining missions on a single spacecraft system and using commercial parts and techniques.

One long-standing FFRDC issue has been whether to fund sponsored research as a cost-reimbursable item or out of fee. A 1962 report to the President on government contracting for research and development, known as the Bell report, supported the continuation of fee payments for research because most nonprofit organizations must conduct some independent, self-initiated research if they are to attract and retain staff.³ On the other hand, an August 1965 congressional report on Aerospace noted that some research would normally be a reimbursable expense and therefore all of the research could be provided under reimbursement.⁴ Similarly, in December 1994, the DOD Inspector General concluded that FFRDC-sponsored research should be reimbursed as contract costs to the extent that is allowable and reasonable.⁵ Most recently, in May 1995, a DOD study, completed at the direction of the Congress, focused on ways to limit the use of fee. It recommended that all allowable and allocable costs, including research, be considered as reimbursable costs rather than paid from fee.⁶

Although Aerospace believes that either funding approach is correct, it believes that research is best funded using fee rather than being reimbursed as a cost item. It said that making research a cost-reimbursable item would decrease the responsibility of Aerospace management and the Board of Trustees over independent research and increase administrative burden. Also, Aerospace expressed concern that Air Force program managers may not want to fund certain research

³Government Contracting for Research and Development, Bureau of the Budget, April 1962.

⁴The Aerospace Corporation: A Study of Fiscal and Management Policy and Control, Report of the Subcommittee for Special Investigations, Committee on Armed Services, House of Representatives, August 12, 1965.

⁵Contracting Practices for the Use and Operations of DOD-Sponsored Federally Funded Research and Development Centers, Audit Report No. 95-048, DOD Inspector General, December 2, 1994.

⁶Comprehensive Review of the Department of Defense's Fee-Granting Process for Federally Funded Research and Development Centers, Department of Defense, May 1, 1995.

because these managers may have more immediate goals than those for Aerospace's research program. Air Force officials said they acknowledged Aerospace's expertise and plan to use it to the maximum extent possible regardless of the funding mechanism.

Reimbursing research as a cost item would not necessarily reduce total Air Force contract costs, according to DOD. However, it would subject all research to the FAR cost principles applicable to cost-reimbursable items.

Regardless of how Aerospace's research program is funded, Air Force and Aerospace officials acknowledged that the program's effectiveness in meeting Air Force needs could be improved. Air Force officials said that the benefits from research could be increased by strengthening Air Force and Aerospace coordination on project selection. According to Aerospace, the effectiveness of the program will be improved as a result of recent steps taken to improve the research selection process. These include (1) a formal collection of prioritized Air Force Technology Need Statements, (2) Air Force participation on Aerospace's Technical Program Committee, and (3) a formal briefing by Aerospace to the Air Force demonstrating the relationship between selected research projects and the Air Force's prioritized technology needs.

Capital Equipment and Real and Leasehold Property Improvements

In fiscal year 1993, Aerospace spent \$18.1 million of its working capital funds for capital equipment (\$14.3 million) and for real and leased property improvements (\$3.8 million). Aerospace officials said these expenditures were funded from reimbursements for depreciation and amortization (\$14.5 million) and the Air Force contract fee (\$3.6 million). The FAR allows as reimbursable costs depreciation of capital equipment and amortization of real property and leasehold improvements.

SMC defines capital equipment as an asset that has an estimated useful life of over 2 years and a cost of \$1,500 or more. It includes those items that Aerospace generally uses to support Air Force contracts but are not purchased in direct support of an individual project, such as computer hardware and bundled software and laboratory diagnostic and test tools. Capital equipment used in direct support of an individual Air Force project is charged as other direct costs in the year acquired rather than depreciated. DOD's May 1995 report to the Congress recommended requiring FFRDCs to submit an annual 5-year capital acquisition plan. According to Aerospace, such a plan may be impracticable due to rapid changes in personnel, technology, and equipment.

Real and leasehold property improvements include building rehabilitation projects, building equipment replacement, security and safety requirements, new operational requirements, and seismic upgrades to meet earthquake protection standards. On the Aerospace contract, leasehold amortization has been a reimbursable cost, whereas building depreciation has been funded primarily through the Air Force contract fee and other corporate funds.

Unreimbursed Expenses

In fiscal year 1993, Aerospace spent \$1.9 million from fee and other corporate funds on unreimbursed costs, that it considered ordinary and necessary to the FFRDC. Some of these expenses were for contributions, travel in excess of per diem, spouse and guest meals, personal use of company-furnished automobiles, and advertising. Table 3 summarizes Aerospace's unreimbursed expenditures in fiscal year 1993.

Table 3: Aerospace's Unreimbursed Expenses for Fiscal Year 1993

Unreimbursed expense	Amount
New business	\$521,500
Contributions	562,000
Miscellaneous	308,000
Travel in excess of per diem	76,000
Interest expense	22,000
Sundry	422,000
Total	\$1,911,500

New Business

According to Aerospace officials, new business expenses are incurred to broaden Aerospace's involvement in non-DOD business to provide employment and operational stability for Aerospace during periods of declining DOD budgets. The officials said more non-DOD business was needed because it has been impossible for Aerospace to maintain employment stability in an environment of budget ceilings and reduced DOD funding. Further, they said that broadening the corporation's non-DOD business base helps slow attrition and retain the skills and capabilities needed to support the Air Force's space mission. Aerospace noted that employment has declined by 27 percent since 1990. Aerospace believes that inadequate staffing levels could increase the risk of an expensive program failure, which could lead to a serious degradation of national security readiness. Aerospace also said a broader business base also reduces the overhead costs allocated to Air Force contracts. According to Aerospace, the precedent for new business development was set in the late 1960s. At the time, DOD encouraged FFRDCs to make their services

available to other government agencies so that they would transfer their technical expertise to the civilian sector.

SMC officials recognize the benefits of new business development expenses in retaining Aerospace's core capabilities and reducing overhead costs. As a result, the officials said they negotiated reasonable and cost-effective limits on new business expenses in the contracts with Aerospace. For example, they agreed to provide \$400,000 for cost-reimbursable, new business expenses in fiscal year 1993. The officials said they made clear to Aerospace that any new business expenses in excess of the contract limit were not reimbursable and could not be charged to the Air Force contract fee. However, such restrictions were not expressly incorporated into Aerospace's contract.

In addition to the \$400,000, Aerospace spent \$551,500 on new business expenses. Aerospace officials said that \$521,500 came from corporate funds other than the Air Force contract fee and \$30,000 was charged directly to other contracts. Table 4 shows the new business expenses incurred by Aerospace during fiscal years 1990 through 1994.

Table 4: Aerospace New Business Expense for Fiscal Years 1990 Through 1994

Fiscal year	Cost-reimbursable limits	Additional amount paid from other fund sources	Total
1990	\$46,800	\$7,800	\$54,600
1991	85,000	0	59,800
1992	106,000	211,100	317,100
1993	400,000	551,500	951,500
1994	1,200,000	244,900	1,444,900
Total	\$1,837,800	\$1,015,300	\$2,827,900

For fiscal year 1995, Aerospace proposed \$2.5 million in cost-reimbursable new business expenses and \$400,000 for bid and proposal expenses. Aerospace officials said that allocating about 1 percent of its contracts' value for new business was not unreasonable given the continued reduction in budget ceilings; the government's commitment in the sponsoring agreement to a special, long-term relationship; and the avoidance of costs associated with potential reductions in force. SMC officials said they negotiated into the contract a cost-reimbursable amount of \$1.2 million for both new business expenses and bid and proposal expenses, which they believed was an appropriate amount for the anticipated benefits to the Air Force. Air Force Headquarters officials

indicate that they intend to tightly control all non-FFRDC/non-DOD business activities of Aerospace.

Contributions

Aerospace officials said contributions help in hiring quality employees, advancing affirmative action goals, and maintaining favorable relationships within the community. Major cash contributions were broadly categorized as either "community affairs participation" or "gift matching program," and Aerospace spent \$307,000 and \$255,000 for these categories, respectively, in fiscal year 1993. Under the FAR, contributions generally are not reimbursable costs. Accordingly, Aerospace's contributions were not reimbursed as cost items but were funded from its corporate funds, which included the Air Force fee. Aerospace officials said contributions were ordinary and necessary business expenditures that were fully disclosed to the Air Force.

As a result of restrictions on charitable contributions contained in the fiscal year 1995 National Defense Authorization Act, Aerospace and SMC agreed that Aerospace would not make any further charitable contributions from funds obtained from DOD. This agreement was incorporated in the fiscal year 1995 contract.

Miscellaneous

Miscellaneous expenditures from corporate funds totaled \$308,000 for fiscal year 1993 and included \$58,700 for the personal use of company cars, \$143,100 for conference meals and trustee expenses, and \$106,200 for other expenses.

Aerospace corporate officers were provided company cars. The FAR states that the costs of automobiles owned or leased by the contractor are allowable if they are reasonable and the cars are used for company business. Costs relating to the personal use of vehicles by employees (including transportation to and from work) are unallowable. According to Aerospace, the \$58,700 charged to corporate funds for the personal use of company cars was primarily for transportation to and from work and was reported as taxable employee income.

Unreimbursed conference meals and trustee expenses of \$143,100 in fiscal year 1993 included unallowable costs, such as meals for spouses and guests, that were incurred at trustee and other meetings. For example, Aerospace included unreimbursed costs of over \$4,000 for 36 spouses and guests at the Collier Award banquet for the Air Force/industry team that developed the Global Positioning System, of which Aerospace was a key member. Aerospace said these unreimbursed expenses of \$143,100 were

ordinary and necessary. Similar expenditures also were incurred in fiscal year 1994, including bar charges of \$1,764 for 63 people, at a dinner reception during a trustee meeting in March 1994.

Aerospace also incurred \$106,200 for other miscellaneous expenditures in fiscal year 1993 that included advertising, employee recreation activities, and donations of capital equipment.

Travel in Excess of Per Diem

Aerospace said travel expenditures in excess of per diem rates included \$25,000 for airline coupons used to provide business and first-class upgrades for its corporate officers. Under the FAR, airfare costs in excess of the lowest customary standard coach or equivalent airfare offered during normal business hours are generally unallowable for cost reimbursement. Accordingly, Aerospace did not submit the costs of upgrades as cost-reimbursable items, although it obtained SMC approval in 1992 to upgrade to business-class air accommodations for corporate officers on trips longer than 2 hours. SMC accepted Aerospace's justification that these upgrades would enhance officers' productivity. SMC officials said they might need to reevaluate whether airline upgrades should be cost-reimbursable items due to DOD's study to limit fee and new federal guidelines on travel costs.

Interest Expense

Interest expense at Aerospace amounted to \$22,000 in fiscal year 1993. Although neither the FAR nor DFARS specifically defines what are ordinary and necessary expenses for FFRDCs, the contract operating instruction at SMC cites interest expense as an example of an unallowable but ordinary and necessary cost of FFRDC operations.

Sundry

For purposes of this report, sundry includes \$422,000 in costs for (1) certain executive salary and benefits, (2) relocation and special recruiting expenses, (3) achievement awards, (4) educational assignments, and (5) bids and proposals. According to Aerospace, some of these costs are allowable for cost reimbursement under the FAR. However, Aerospace said it paid the costs out of corporate funds to avoid potential controversies with the Air Force or the Defense Contract Audit Agency regarding the costs' allowability. For example, through fiscal year 1993, Aerospace charged to corporate funds the portion of the president/chief executive officer's salary that exceeded the salary for Executive Schedule Level II. Aerospace said it charged the president/chief executive officer's entire salary as a cost-reimbursable item in fiscal year 1994.

Aerospace's Discretion Over Use of Fee

Existing federal regulations provide general guidance regarding how fee is to be determined, but do not restrict how a fee may be used nor define what are ordinary and necessary expenses. Further, neither the Air Force sponsoring agreement with Aerospace nor the annual contract specify how a fee may be used. Although the Air Force and Aerospace discuss Aerospace's need for fee and planned use of fee by cost category, Aerospace exercises some discretion in spending the fee and determining what expenditures funded from fee are ordinary and necessary. Since Aerospace's fee is based on its need, the manner in which Aerospace uses its corporate resources, including fee, in any one year may affect its need for an Air Force fee in the following year.

Aerospace stated that even though it has discretion regarding the use of all corporate resources, including Air Force fee, it attempts to use the resources in a manner that is consistent with the plan presented to the Air Force. Aerospace officials told us they recognize that if Aerospace used its resources in a manner that was inconsistent with the plan discussed with the Air Force, the Air Force might attempt to negotiate a reduced fee in subsequent years. In this regard, Air Force officials told us Aerospace has an inherent responsibility to spend its fee in accordance with the justification of its need, even though it is not specifically required by the contract to do so.

Inadequate Definition of Ordinary and Necessary Expenses

In establishing the fee provided to defense FFRDCs, the DFARS says that consideration should be given to funding unreimbursed costs deemed ordinary and necessary to the FFRDC. DOD's May 1995 report on FFRDC fee management recognized that the guidance in the FAR and DFARS concerning the granting of FFRDC fees is not clear about what unreimbursed costs are considered ordinary and necessary to FFRDC operations. The report recommended that new guidance be developed and that the use of the undefined and ambiguous term "ordinary and necessary" be avoided. The report also recognized the need for specific examples of appropriate fee use.

Implementing this recommendation should provide the Air Force with a better basis for negotiating fee award. An agreed-upon definition of ordinary and necessary expenses would assist contracting officers in resolving issues with other defense FFRDCs. However, as long as moneys provided through Air Force fee are commingled with other funding sources, the Air Force may have difficulty determining how Aerospace used its FFRDC fee.

DOD and Aerospace Comments

In commenting on a draft of this report, DOD stated that it did not dispute the facts contained in the report and indicated that the report would be helpful in the ongoing DOD efforts to strengthen FFRDC oversight and use of management fees. However, DOD said that none of the data in the report represented improper or illegal activity, as defined by existing statute or regulation, on the part of DOD or Aerospace.

DOD further commented that it was taking positive steps to improve its FFRDC fee management process. For example, it said that in the fiscal year 1996 Aerospace contract, the Air Force would address specific uses of fee, such as personal use of cars and travel-related items, through contract provisions or by disallowing the expense. Further, DOD said it was actively working to improve the fee management process based on the findings and recommendations made in DOD's May 1995 report on fee management, as well as work done by us and the DOD Inspector General. DOD's comments are included in their entirety in appendix I.

Aerospace provided specific language clarifications. These changes were incorporated where appropriate.

Scope and Methodology

We examined Aerospace's proposed fee expenditures and the Air Force's and Defense Contract Audit Agency's evaluations of Aerospace's proposals, including audit reports, supporting workpapers, technical evaluations, and Air Force's price negotiation memorandums. We also examined documentation supporting the nature and purpose of selected actual fee expenditures. Further, we obtained the views of Aerospace's officials and cognizant Defense Contract Audit Agency and Air Force program and contracting officials at Aerospace on factors affecting the use of fee.

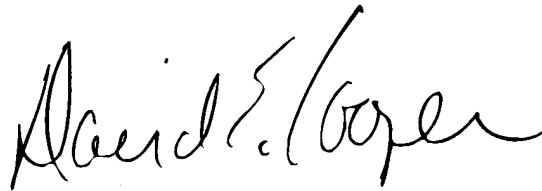
To determine the regulatory requirements governing the determination and use of fee, we reviewed applicable Office of Federal Procurement Policy guidance; FAR and DFARS provisions; Air Force operating instructions and procedures; and Air Force correspondence, contracts, and sponsoring agreement with Aerospace. We reviewed Aerospace's use of fee for fiscal year 1993 because, at the time we began our work, it was the most recently completed year for which Aerospace had submitted its schedule of unreimbursed expenditures.

We also exchanged information with DOD staff involved in the congressionally mandated DOD study on FFRDC fees during their study of the current fee determination process and fee management issues.

We conducted our work from October 1994 to July 1995 in accordance with generally accepted government auditing standards.

Unless you publicly announce its contents earlier, we plan no further distribution of this report until 30 days from its issue date. At that time, we will send copies to the Secretary of Defense; the Director, Office of Management and Budget; the Administrator, Office of Federal Procurement Policy; and other interested congressional committees. Copies will also be available to others upon request.

Please contact me at (202) 512-4587 if you or your staff have any questions concerning this report. Major contributors to this report are listed in appendix II.

A handwritten signature in black ink, reading "David E. Cooper". The signature is fluid and cursive, with the first name "David" and last name "Cooper" clearly legible.

David E. Cooper
Director, Acquisition Policy, Technology,
and Competitiveness Issues

Comments From the Department of Defense



DIRECTOR OF DEFENSE RESEARCH AND ENGINEERING
3030 DEFENSE PENTAGON
WASHINGTON, D.C. 20301-3030



31 AUG 1995

Mr. David E. Cooper
Director, Acquisition Policy,
Technology, and Competitiveness Issues
National Security and International
Affairs Division
U.S. General Accounting Office
Washington DC 20548

Dear Mr. Cooper:

This is the Department of Defense (DoD) response to the General Accounting Office (GAO) draft report, "FEDERALLY FUNDED R&D CENTERS: Use of Fee by the Aerospace Corporation, dated July 28, 1995 (GAO Code 705086/OSD Case 9838-A)." The DoD generally concurs with the draft report.

The Department does not dispute any of the facts contained in the report. Also, the information presented in the report will be very helpful to ongoing DoD effort to strengthen its procedures for the oversight and use of management fees by DoD sponsored Federally Funded Research and Development Centers (FFRDCs). However, it should be emphasized (and the report should so state) that none of the data presented in your report represents improper or illegal activity, as currently defined by statute or regulation, on the part of either the Department of Defense or the Aerospace Corporation.

Additionally, while the Department understands that the report highlights data from the FY 1993 Air Force contract with the Aerospace Corporation (as examples of problems related to the issue of management control of fees) it would be appropriate for the GAO to acknowledge some of the positive steps the Air Force is taking to improve its FFRDC fee management process. For example, in the Fiscal Year 1996 contract, the Air Force will address some miscellaneous uses of fee, such as personal use of cars and travel related items, through specific contract provisions or by simple disallowance of the expense.

As the GAO report notes, the Department recently completed a study titled "Comprehensive Review of the DoD's Fee-Granting Process" and provided it to the Congress in May 1995. The DoD is actively working to implement the positive improvements to the fee management process with respect to the findings and

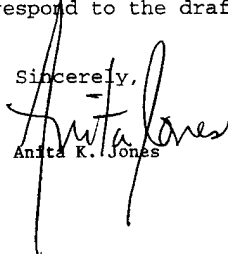


Appendix I
Comments From the Department of Defense

recommendations made in that report, as well as the most recent GAO and DoD Inspector General work on FFRDC management fees.

Thank you for the opportunity to respond to the draft GAO report.

Sincerely,


Anita K. Jones

Major Contributors to This Report

National Security and
International Affairs
Division, Washington,
D.C.

Charles W. Thompson

Office of the General
Counsel

Ernie E. Jackson

Los Angeles Field
Office

Odi Cuero
Benjamin H. Mannen
Amborse A. McGraw